(5)

No. 86-88

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

CITICORP INDUSTRIAL CREDIT, INC.,
Petitioner,

v.

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF FOR THE PETITIONER

REX E. LEE *
GEORGE W. JONES, JR.
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000

A. BRUCE SCHIMBERG
SIDLEY & AUSTIN
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

Counsel for the Petitioner

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

68 pp

QUESTION PRESENTED

Whether, in enacting the Fair Labor Standards Act, Congress intended not only to establish minimum wage rates, but also to displace the rights of bona fide purchasers and lienholders established by state and other federal law.

LIST OF PARTIES

In addition to the parties identified in the caption of the case, Ely Group, Inc. and two entities identified as Ely Group subsidiaries, Rockford Textile Mills, Inc. and Ely & Walker, Inc., were named defendants in the Secretary's complaints. Neither Ely Group nor any Ely Group subsidiary participated in the proceedings in the court of appeals.*

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* The petition for a writ of certiorari contains the disclosures required under Rule 28.1 of the Rules of this Court.

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 788 F.2d 1200. The opinions of the district courts (Pet. App. 18a-33a) are reported at 608 F. Supp. 215 (E.D. Tenn.), and 621 F. Supp. 22 (W.D. Tenn.).

JURISDICTION

The judgment of the court of appeals (Pet. App. 17a) was entered on April 23, 1986. The petition for a writ of certiorari was filed on July 22, 1986, and granted on November 3, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 15(a)(1) of the Fair Labor Standards Act of 1938 (29 U.S.C. § 215(a)(1)) provides:

> (a) After the expiration of one hundred and twenty days from June 25, 1938, it shall be unlawful for any person—
>
> (1) to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title, or in violation of any regulation or order of the Administrator issued under section 214 of this title; except that no provision of this chapter shall impose any liability upon any common carrier for the transportation in commerce in the regular course of its business of any goods not produced by such common carrier, and no provision of this chapter shall excuse any common carrier from its obligation to accept any goods for transportation; and except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful;

Sections 6 and 7 of the Fair Labor Standards Act of 1938 (29 U.S.C. §§ 206, 207), which prescribe minimum regular wage rates and overtime wage rates for covered employees, are reproduced in the appendix to the petition for a writ of certiorari. Pet. App. 36a-56a.

STATEMENT OF THE CASE

The Sixth Circuit's decision in this case ignores two common sense distinctions. The first is the distinction—unquestioned for nearly 50 years—between wage and hour standards and creditors' rights. The second is between innocence and culpability. Both are fundamental, and compel reversal.

Traditionally, creditors' rights (including employee wage claims) against insolvent debtors not in bankruptcy have been governed by a well-developed set of interrelated state laws. On the few occasions when Congress has acted in this area of creditors' rights, the legislation has been drawn narrowly, leaving the area of creditors' rights outside bankruptcy governed almost exclusively by state law. In bankruptcy, of course, the federal Bankruptcy Code governs. By contrast, the relationships between employees of ongoing businesses and their employers have been governed by an entirely separate and distinct body of law.

The Fair Labor Standards Act of 1938 ("FLSA") is one of several general federal statutes addressing employer-employee relations. The focus of the FLSA is the wage rates and hours of employees of ongoing businesses. The Act does not purport to govern in any way the consequences of an employer's insolvency or to modify the priority of creditors' claims against an insolvent debtor's assets. In addition, there is no evidence that the FLSA was intended to make innocent persons responsible for any employer's payroll obligations.

The Sixth Circuit held that in enacting the FLSA Congress intended not only to establish decent wage rates and hours for American workers, but also to preempt the substantial body of state law governing creditors' rights against insolvent debtors, and to repeal provisions of the bankruptcy law by implication. In the nearly 50 years since the FLSA was enacted, no other court of appeals has interpreted the statute to require such an extraordinary conclusion.

1. *Factual context.* This case arises out of a typical commercial secured lending transaction. Ely Group, Inc. ("Ely") is a defunct manufacturer of hosiery and shirts.

In December, 1983, petitioner Citicorp Industrial Credit, Inc. ("Citicorp") and Ely executed a standard financing agreement. C.A. App. 343-411; see *id.* 340-342.[1] Ely granted Citicorp a security interest in its accounts receivable and inventory as collateral to secure repayment of loans to be made by Citicorp under the agreement. C.A. App. 356-357.[2] Citicorp "perfected" its security interests under applicable state law (Article 9 of the Uniform Commercial Code) by filing financing statements with appropriate state officials. Pet. App. 2a, 19a-20a; C.A. App. 33, 44, 75, 288, 418.[3]

Approximately one year later, Ely defaulted on its obligations under the financing agreement, and on February 11, 1985, Citicorp notified Ely that no additional funds would be advanced. C.A. App. 412-413. The financing agreement provides that the law of Georgia governs the rights and obligations of the parties. C.A. App. 383. Under Georgia law, Citicorp's perfected security interest in the Ely inventory is senior to all secured and unsecured claims to that inventory, including employee wage liens created by state statute. See Ga. Code Ann. §§ 11-9-310, 44-14-320 (1982).[4] Accordingly, under Georgia law

[1] "C.A. App." refers to the joint appendix filed in the court of appeals. When the financing agreement was executed, Ely Group was known as Qualitex Corporation. Pet. App. 2a.

[2] Under the agreement, payments from Ely's customers were deposited in a Citicorp account, and applied against the advances made by Citicorp. C.A. App. 189-190, 208-209, 321-322.

[3] "Perfection" by filing with designated state officials is the procedure established under Article 9 of the Uniform Commercial Code for recording security interests, and thereby putting prospective creditors on notice of prior claims against almost every type of property of a debtor. *See generally* 1 G. Gilmore, *Security Interests in Personal Property* 435-437, 462-480 (1965).

[4] A "lien" is a charge against property for the payment of a debt and gives the creditor lienholder the right to have the debt satisfied out of the proceeds of sale of the particular property to which the lien attaches. *See Ballentine's Law Dictionary* 737 (3d ed. 1969).

Citicorp would have been entitled to take possession of and sell the Ely inventory in satisfaction of its claims, without regard to the claims of Ely's employees for unpaid wages.[5]

At the request of Ely's management, Citicorp delayed exercising its right to take possession of the inventory to give Ely an opportunity to devise a plan to continue operations and to pursue alternative sources of financing. C.A. App. 301-302. Approximately one week later, on February 19, 1985, Ely ceased operations, and turned over the inventory collateral to Citicorp. Pet. App. 3a. Citicorp then planned to collect Ely's receivables, and to liquidate the inventory collateral and apply the proceeds against the outstanding Ely loan balance of approximately $9.5 million. See Pet. App. 3a.

When Ely ceased operations, it owed its employees wages for work performed during the immediately preceding weeks. Pet. App. 27a, 29a-30a. Some payroll checks issued on February 8 had been dishonored for insufficient funds; no payroll checks were issued after that date. C.A. App. 120, 281. Ely is therefore liable under state law for the wages due its employees. The precise amount of unpaid wages has not been determined.

2. *District court proceedings.* In March, 1985 respondent Secretary of Labor filed two suits under Sections 15, 16, and 17 of the Fair Labor Standards Act (29 U.S.C. §§ 215, 216, 217) against Ely and Citicorp in the United States District Courts for the Eastern District of Ten-

[5] Statutory liens for employee wages also are provided for by statute in Arkansas and Tennessee, where Ely's facilities were located. *See* Ark. Stat. Ann. §§ 51-505, 51-301 (1971); Tenn. Code Ann. § 66-13-101 (1982). The priority of Citicorp's security interest over employee wage liens under Tennessee law, if applicable, is the subject of pending state court litigation. *Bobbie Atnip* v. *Ely Group, Inc., et al.*, No. 3724 (Chancery Court, Warren Cty., Tenn.) (filed Feb. 25, 1985).

nessee and the Western District of Tennessee.[6] In both actions, the Secretary sought to enjoin the sale or shipment of all Ely inventory; the Secretary also sought a judgment against Ely for unpaid wages and liquidated damages on behalf of Ely employees. C.A. App. 4-7 (E.D. Tenn.), 110-114 (W.D. Tenn.).

Sections 6 and 7 of the FLSA prescribe minimum regular wage rates and overtime wage rates for covered employees. 29 U.S.C. §§ 206, 207 (Pet. App. 36a-56a). Section 15(a)(1), one of several mechanisms Congress adopted to induce employers to comply with the substantive provisions of the Act, makes it unlawful for "any person" to transport, sell, or ship in commerce goods produced by employees not paid the prescribed minimum wages. Section 16 authorizes the Secretary to seek unpaid minimum wages and liquidated damages on behalf of employees. Under Section 17 of the Act, federal district courts have jurisdiction to enjoin violations of Section 15.

The Secretary maintains that an insolvent employer's financial inability to pay employees in accordance with their respective employment contracts violates the minimum wage and overtime provisions of the FLSA. It is undisputed that Ely's wage rates exceeded the minimum requirements of Sections 6 and 7 of the FLSA. C.A. App. 34; see Pet. App. 13a.

There is no evidence of wrongdoing by Citicorp, or of any participation by Citicorp in Ely management's decisions concerning the use of funds to pay employees or other creditors. Pet. App. 25a-26a, 32a; see Pet. App. 10a. On the basis of the asserted violation of Sections 6

[6] *Donovan* v. *Rockford Textile Mills, Inc., Ely Group, Inc., and Citicorp Industrial Credit, Inc.*, Civ. Action No. 4-85-26 (E.D. Tenn.) (complaint filed March 15, 1985); *Ford* v. *Ely Group, Inc., Rockford Textile Mills, Inc., Ely & Walker, Inc., and Citicorp Industrial Credit, Inc.*, Civ. Action No. 85-2276H (W.D. Tenn.) (complaint filed March 21, 1985).

and 7 by Ely, however, the Secretary invoked Section 15(a)(1) against Citicorp, arguing that because Section 15(a)(1) makes it unlawful for "any person" to sell goods produced in violation of the Act, Congress intended it to apply to secured creditors who had nothing to do with either the establishment of employee wage rates or the payment of employee wages. Under the Secretary's theory, when a secured creditor takes possession of "tainted" goods pursuant to a valid security agreement and in accordance with applicable state law, the creditor may not sell the collateral, unless the debtor's employees are paid first, without regard to state law governing the relative priority of creditors' claims.

In the district court, counsel for the Secretary candidly admitted both the motivation for, and the practical effect of, invoking Section 15(a)(1) against a secured creditor. Responding to questions from the district court, counsel agreed that the injunction sought against Citicorp was "judicial extortion." C.A. App. 66-67. Counsel for the Secretary explained that although an injunction entered under Section 15(a)(1) would not "order any payment by anyone," it "puts pressure on either party [*i.e.*, the insolvent employer and the secured creditor] to arrange for payment [of employee wages]." C.A. App. 42-43. See also C.A. App. 57, 58. Similarly, counsel for the Secretary acknowledged that invoking Section 15(a)(1) against a secured creditor effectively gave the employees priority, notwithstanding any contrary state law. See C.A. App. 57 (counsel for the Secretary noted "[w]e're saying employees have priority").[7]

[7] *See also* C.A. App. 67 (emphasis added):

"The Court: So you are just simply saying any time . . . that any kind of goods are moved in the United States, and the minimum wage is not paid, that all those goods have to sit where they are, *and a creditor has no lien ahead of the payroll*, is that right?

"[Counsel for the Secretary]: Yes, sir."

Both district courts accepted the Secretary's theory, and enjoined Citicorp from selling any Ely inventory produced during the period for which Ely employees had not been fully paid.[8] Over the opposition of the Secretary, the district court judgments were stayed pending appeal. Citicorp was permitted to sell the inventory collateral on condition that it hold the proceeds of sales in a separate account and agree to pay the statutorily required wages due Ely employees, if Section 15(a)(1) were held applicable.[9]

3. *Court of appeals proceedings.* The cases were consolidated in the United States Court of Appeals for the Sixth Circuit. In affirming the district court judgments, the court of appeals explicitly declined to follow the contrary holdings in *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971), and *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir. 1966). Pet. App. 7a-8a.[10] In *Powell Knitting*, the Second Circuit rejected the Secretary's assertion that Congress intended Section 15(a)(1) to be used to modify state priority rules or as a means to force an innocent secured creditor to pay the wages of the employees of an insolvent: "[W]ithout some reasonably clear reference to the problem in the Act or in its history we find it hard to believe that Congress contemplated that the foreclosing creditor

[8] C.A. App. 79-80, 427.

[9] Pet. App. 4a; C.A. App. 104-105, 432-433; *see* Pet. App. 10a n.9 ("Citicorp . . . removed the 'taint' from the goods by agreeing to pay the statutorily required wages if . . . 29 U.S.C. § 215(a)(1) applies to secured creditors"). Subsequently, the conditions of the stay were modified to allow Citicorp to reduce the amount of money held separate for payment of Ely employee wage claims to $1.5 million. Pet. App. 34a-35a.

[10] In *Shultz* v. *Factors, Inc.*, the Fourth Circuit adopted the reasoning in *Powell Knitting*, adding the explicit caveat that a different result might be appropriate if there were evidence of a secured creditor's "complicity" in any attempt to circumvent the substantive requirements of the FLSA. 65 Lab. Cas. 44,732.

would have to pay the wage earners to avoid § 15." 360 F.2d 733.

The Sixth Circuit acknowledged that "Congress never directly considered the question whether the 'hot goods' provision [29 U.S.C. § 215(a)(1)] applies to secured creditors." Pet. App. 12a. Nonetheless, relying on the phrase "any person" in Section 15 and its view that enforcing Section 15(a)(1) against a secured creditor would further Congress' purpose to protect business against competition from goods produced under substandard labor conditions, the majority held that an innocent secured creditor foreclosing on inventory collateral was subject to injunction under Section 15. Pet. App. 4a-7a.[11]

Judge Engel dissented, stating that, after decades of settled law in this area, the court should follow the construction of the FLSA adopted by the other courts of appeals, absent compelling reason for rejecting that view. Moreover, Judge Engel argued that the minimum wage provisions of the Fair Labor Standards Act were never intended to apply to an insolvent employer, unable to pay any wages at all. Pet. App. 13a. Judge Engel recognized that the Secretary's only "motivation" for invoking Section 15 against a secured creditor of a financially distressed employer was to pressure the creditor to pay the wages of its debtor's employees. Pet. App. 15a. Judge Engel explained that, in holding Section 15(a)(1) applicable to a secured creditor, the majority effectively "create[d] a judicial lien superior to the otherwise lawful lien which Citicorp possessed in the goods." Pet.

[11] As noted above (page 8 & note 9, *supra*), the court of appeals permitted Citicorp to sell the inventory on condition that it agree to pay the Ely employees' unpaid, statutorily required wages if Section 15(a)(1) were held applicable under the circumstances of this case. The court thus implicitly rejected any suggestion that the inventory was either inherently or permanently "tainted" contraband.

App. 15a. Since there was no evidence Congress intended Section 15 to apply to a secured creditor, Judge Engel concluded that Congress intended to permit the claims of employees of insolvent corporations to be governed by "traditional sources of law," namely, "[s]tate laws governing creditors' rights, state laws protecting employees from non-payment of wages and bankruptcy laws generally." Pet. App. 15a.

SUMMARY OF ARGUMENT

The Secretary of Labor maintains that an insolvent employer's failure to meet the last payroll before shutting down operations violates the minimum wage and hour standards of the Fair Labor Standards Act, and therefore that the "hot goods" provision of the Act (29 U.S.C. § 215(a)(1)) is properly invoked against wholly innocent persons who acquire goods produced by the insolvent's employees. Both propositions defy common sense; the latter is demonstrably incorrect.

For 150 years prior to the enactment of the Fair Labor Standards Act of 1938 ("FLSA"), the priority of creditors' claims against the assets of insolvent debtors not in bankruptcy was governed by state law. For nearly 50 years after the Fair Labor Standards Act was adopted, the bright line between creditors' rights on one side and wage and hour standards on the other remained clear. The Sixth Circuit's construction of Section 15(a)(1) in this case is the only departure from that clear line. In holding that Section 15(a)(1) of the FLSA may be invoked to freeze goods in the possession of an innocent secured creditor attempting to foreclose a prior perfected security interest in inventory collateral, the Sixth Circuit effectively created a federal wage lien. Unless the creditor pays (or in this case agrees to pay) the wages due the employees of its insolvent debtor, the inventory collateral cannot be sold. The lien created by the Sixth Circuit preempts contrary state law throughout

the nation and repeals by implication other federal law explicitly addressing creditors' rights.

The plain language of the Fair Labor Standards Act provides no basis for the court of appeals' conclusion that Congress intended to preempt the substantial body of state law governing the priority of creditors' claims against the assets of insolvent debtors. On the contrary, the language and structure of the FLSA reflect Congress' limited purpose and intention to improve the wages and hours of the employees of ongoing businesses by establishing minimum labor standards. Section 15(a)(1) of the FLSA was intended as a mechanism to induce employers to comply with the substantive wage and hour standards prescribed in the Act. Section 15(a)(1), like the substantive provisions of the Act, deals with the limited problem of "chiseling" employers who refused to pay decent wages, not the very different problem of collecting wages from insolvent employers. Nothing in the language of the FLSA purports to address the consequences of an insolvent employer's inability to pay agreed wages in excess of the minimum rates prescribed in the substantive provisions of the Act, or to preempt the state law of creditors' rights.

The legislative history of the FLSA confirms that Section 15(a)(1) was aimed at chiseling employers and those who aided them in attempting to circumvent the substantive wage and hour provisions. The provision was never intended to be invoked against any person who innocently acquired hot goods in good faith, without complicity in any scheme to circumvent the substantive wage and hour standards prescribed in the Act. Congress amended Section 15(a)(1) in 1949 to confirm the originally intended scope of Section 15(a)(1). Contrary to the Secretary's current interpretation, in 1949 Congress made it clear that Section 15(a)(1) was never intended to make innocent purchasers of hot goods responsible for the failure of their sellers to abide the substantive requirements of the FLSA.

Given the limited purpose of the FLSA, it is inconceivable that Congress actually considered and intended to establish a federal wage lien with priority over a perfected secured creditor. The 1938 amendments to the Bankruptcy Act of 1898 (amendments commonly referred to as the Chandler Act) eliminate all doubt. Just three days before the Fair Labor Standards Act became law, Congress amended the bankruptcy laws, but continued to recognize the validity of prior perfected liens as against the claims of unsecured creditors, including employee wage claims. Thus, employee wage claims remained junior to prior perfected security interests. Unlike the FLSA, the Bankruptcy Act addresses the priority of creditors' claims against the assets of an insolvent debtor. The Sixth Circuit's interpretation of the FLSA requires the erroneous conclusion that three days after amending the Bankruptcy Act, Congress silently repealed it in part in legislation addressing an entirely different subject. The same conflict exists under the Bankruptcy Code today; in addition to the Bankruptcy Code, the holding of the Sixth Circuit improperly repeals by implication several other federal statutes that specifically address the priority of creditors' claims to the assets of an insolvent debtor.

Whether the product of a decision of this Court or a well-reasoned decision of a lower federal court, a settled construction of a national statute should not be revisited without good reason. In this case, there is none. The decision of the Second Circuit in *Powell Knitting* was correct in 1966, and in 1971 when the Fourth Circuit adopted its reasoning in *Shultz* v. *Factors, Inc.* The common sense distinction between wage and hour legislation and creditors' rights legislation recognized in *Powell Knitting*, is no less valid today; in the intervening decades commercial finance industry practices and loan agreements have been developed in reliance on that distinction. The laws governing creditors' rights and the laws governing wage and hour legislation have stood side-by-side for at least 50 years, each operating independent of the other, with no ill effects. There is no reason to stretch the Fair Labor Standards Act to reach an area it was never intended to govern.

ARGUMENT

THE FAIR LABOR STANDARDS ACT SHOULD NOT BE CONSTRUED TO PREEMPT OR REPEAL STATE AND FEDERAL LAW GOVERNING THE RELATIVE PRIORITY OF CREDITORS' CLAIMS AGAINST INSOLVENT DEBTORS

Resolution of the question presented depends on congressional intent. In holding that Section 15(a)(1) of the FLSA may be used to compel a secured creditor to pay the wages of its debtor's employees, the Sixth Circuit effectively established an unfiled (see note 3, page 4, *supra*) and, therefore, undiscoverable "secret" lien for wages with super-priority over prior perfected security interests in inventory collateral, contrary to the order of priority generally prescribed under state law as well as under the Bankruptcy Code.[12] As construed by the Sixth Circuit, therefore, the Fair Labor Standards Act preempts state law governing the priority of creditors' claims against the assets of insolvent debtors and repeals by implication other federal law specifically addressing creditors' rights.

"The critical question in any pre-emption analysis is always whether Congress intended that federal regulation supersede state law." *Louisiana Public Service Commission* v. *Federal Communications Commission*, 106 S. Ct. 1890, 1899 (1986).[13] Similarly, "absent a clearly

[12] Under both Article 9 of the Uniform Commercial Code and the Bankruptcy Code, a prior perfected security interest generally is senior to employee wages claims and liens. *See* pages 38-40, 43, *infra*.

[13] "Preemption occurs when Congress, in enacting a federal statute, expresses a clear intent to pre-empt state law . . ., when there is outright or actual conflict between federal and state law . . ., where compliance with both federal and state law is in effect

expressed congressional intention to the contrary," a federal statute should not be construed as an implicit repeal of other federal law. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1018 (1984).

The Secretary's burden of demonstrating that Congress intended to preempt state law or repeal other federal law governing creditors' rights cannot be sustained in this case. State law and federal bankruptcy law traditionally determined whether and to what extent wage claims of employees of insolvent businesses should be afforded special protection. The focus of the FLSA was the ongoing relationship between employers and their employees. In enacting the FLSA, Congress intended only to establish minimum regular and overtime wage rates, and to prescribe rules for the employment of children. There is no evidence that in enacting the FLSA Congress intended to address the priority of creditors' claims against the assets of insolvent debtors. Neither the Secretary nor the Sixth Circuit majority has cited anything that suggests that Congress ever considered the problem of whether the wage claims of the employees of insolvent businesses should be preferred over the claims of secured creditors.

A. The Language and Structure of the FLSA Demontrate That Section 15(a)(1) Was Not Intended to Preempt State Law Governing the Priority of Creditors' Claims Against Insolvents.

When read in the light cast by the substantive wage and hour provisions of the FLSA and the object and

physically impossible . . ., where there is implicit in federal law a barrier to state regulation . . ., where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law . . ., or where state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress." *Louisiana Public Service Commission* v. *FCC*, *supra*, 106 S. Ct. 1898 (citations omitted).

policy of the Act, it is plain that Section 15(a)(1) was never intended to prevent a secured creditor from liquidating inventory collateral in accordance with state law governing the rights of creditors.[14] Nor was it intended to be used as a club for "judicial extortion" (C.A. App. 66-67) to coerce a person who innocently acquired hot goods to pay the wages of the employees of an offending employer.

Language of § 15(a)(1). Section 15(a)(1) makes it unlawful for "any person" "to transport, offer for transportation, ship, deliver, or sell in commerce . . . any goods in the production of which any employee was employed in violation of section 6 or section 7" of the FLSA. By its terms Section 15(a)(1) does not create any rights of any kind for employees. There is no provision for recovery of unpaid wages by the government on behalf of employees under Section 15(a)(1).[15] The language of

[14] *See Kelly* v. *Robinson*, 107 S. Ct. 353, 358 (1986), quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring) ("[T]he 'starting point in every case involving construction of a statute is the language itself.' But the text is only the starting point."); *Offshore Logistics, Inc.* v. *Tallentire*, 106 S. Ct. 2485, 2494 (1986) (internal quotation marks and citations omitted) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy").

[15] As enacted in 1938, the FLSA contained no provision at all for recovery of unpaid wages by the government on behalf of employees. Section 16 made an employer who failed to meet the minimum wage rate requirements liable to his employees for the amount of unpaid minimum wages and liquidated damages. 52 Stat. 1069. An aggrieved employee could sue his employer in any court of competent jurisdiction, but no action on his behalf by the Administrator of the Wage and Hour Division of the Department of Labor was authorized. Congress amended Section 16 of the statute in 1949 to allow the Secretary of Labor to sue an offending employer for unpaid wages on behalf of aggrieved employees. 63 Stat. 919, as amended, 29 U.S.C. § 216(c); *see generally Donovan* v. *Brown Equipment and Service Tools, Inc.*, 666 F.2d 148, 155-156 (5th Cir. 1982).

Section 15(a)(1) does not purport to create a federal wage lien on the assets of an offending employer. Nor does the provision purport to preempt state law rules governing the priority of creditors' claims against the assets of insolvent debtors. On its face, Section 15(a)(1) simply does not address the subject of creditors' rights. It is only a mechanism to encourage compliance with substantive requirements prescribed elsewhere in the Act.

Structure of the FLSA. As enacted in 1938, the FLSA accomplished three substantive objectives, two of which the Secretary relies on in this case. Section 6 prescribed minimum regular hourly wage rates.[16] Section 7 prescribed minimum overtime hourly wage rates.[17] The substantive requirements of Sections 6 and 7 govern the wages to be paid by "employers." Pet. App. 46a, 43a. Those provisions address wage rates, rather than the problem of nonpayment due to insolvency. The language of those provisions gives no hint that they were intended to govern the consequences of an employer's insolvency, or otherwise address the subject of creditors' rights against insolvents.

Moreover, as a practical matter, the substantive provisions of the Act are meaningful only in the context of an ongoing solvent business, since an employer cannot pay money it does not have.[18] If, as in this case, an employer contracts to pay wages in excess of the statutory minima, but cannot meet the payroll in the weeks before shutting down operations due to insolvency, the substantive requirements of the FLSA add nothing. The employer's obligation under state law to pay the full amount of the wages due is not in dispute. The problem is a practical one of collection. If the employer had sufficient assets, the wages would be paid, or the employee could collect on his state law contract claim. If the employer has insufficient assets, the employee is not going to collect, however many independent legal grounds he may enjoy as the basis for collecting his wages. Accordingly, the substantive provisions of the Act necessarily were aimed principally at the wage rates and hours of employees of ongoing solvent businesses.

Like the substantive provisions of the Act, Section 15(a)(1) was aimed principally at ongoing solvent businesses. The threat of an injunction against the offending employer carries little weight when, as in this case, the employer is forced to cease operations due to insolvency.[19] Further, while Section 15(a)(1) refers to "any person," that language must be interpreted in light of the substantive provisions it was intended to enforce. It is difficult to imagine circumstances in which the threat of invoking Section 15(a)(1) against a secured creditor or any other person who innocently acquires hot goods would encourage compliance by an offending employer.

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[16] 52 Stat. 1062-1063, as amended, 29 U.S.C. § 206 (Pet. App. 36a-42a).

[17] 52 Stat. 1063-1064, as amended, 29 U.S.C. § 207 (Pet. App. 43a-56a). The third important substantive objective of the 1938 legislation was the establishment of child labor standards. *See* FLSA §§ 3(l) and 12, 52 Stat. 1061, 1067, as amended, 29 U.S.C. §§ 203(l), 212.

[18] In arguing that the substantive provisions of the FLSA are applicable even though the employer is insolvent, counsel for the Secretary recognized the empty formalism of the Secretary's interpretation of the Act (C.A. App. 35):

> "[I]t's a matter of whether you can collect it[;] they're liable for it. It's a matter, whether you can collect it[;] we're a creditor like other people[;] we can still get an injunction against [the insolvent] withholding [wage payments]. It's just a practical problem of collecting it."

[19] *See Donovan* v. *Brown Equipment and Service Tools, Inc.*, 666 F.2d 148, 157 (5th Cir. 1982). ("If, for example, the employer is bankrupt, an injunction would be in vain and the employer should not be threatened with citation for contempt for not doing what he is unable to do").

That is particularly true where the employer's asserted violation is due solely to insolvency.[20]

Furthermore, to invoke Section 15(a)(1) against a secured creditor to freeze inventory collateral (unless employees are paid first) effectively creates a federal lien superior to the security interest. See page 7, *supra*. It is, however, a lien whose existence depends on whether the Secretary decides to file suit under Section 15a(1). Only the Secretary can file such an action. See 29 U.S.C. § 211(a). One of the several anomalous aspects of the Secretary's interpretation of the FLSA in this case, therefore, is the implication that Congress intended to establish priority for employee wage claims, but only if the Secretary chooses to bring an action under Section 15(a)(1).

Even if, as the Secretary maintains, the FLSA is applicable in the context of an insolvent employer, there is no basis whatever in the language or structure of the Act for the Secretary's further assertion that in adopting Section 15(a)(1) of the Act Congress intended that the wage claims of "employees have priority" (C.A. App. 57) over the claims of secured creditors, without regard to state law. Whether an employee sues on his own behalf or the Secretary files suit under Section 15(a)(1) of the Act, the employee is "a creditor like other people" (note 18, page 17, *supra*), and is entitled to no greater priority than is provided under applicable state law.

[20] As passed by the Senate, the FLSA defined "person" to include a "receiver, trustee, trustee in bankruptcy, or liquidating or reorganizing agent." Conference Report, reprinted, 83 Cong. Rec. 9250 (June 14, 1938). The House definition did not, *id.* 9252, and the conferees adopted the House definition. *Id.* at 9253. Without more, the unexplained omission of the specific reference to trustees in bankruptcy and similar persons proves nothing. Here, however, the omission tends to confirm what is apparent from the language and structure of the FLSA, namely, that Congress' primary concerns were the wages and hours of the employees of ongoing businesses.

B. The Legislative History of the FLSA Confirms That Section 15(a)(1) Was Not Intended to Preempt State Law Governing the Priority of Creditors' Claims Against Insolvents.

Nothing in the legislative history of the FLSA evidences any Congressional intent to preempt state creditors' rights law. Moreover, the legislative history is clear that Congress did not intend Section 15(a)(1) to be used against any innocent purchaser of hot goods, such as Citicorp.

1. The sole purpose of the FLSA was to establish minimum regular and overtime wage rates.

Congress' limited purpose. The Fair Labor Standards Act of 1938 had one purpose: to establish decent wages and hours for American workers.[21] In enacting the FLSA, Congress intended "to correct and as rapidly as practicable to eliminate," 29 U.S.C. § 202(b), "*labor conditions* detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and [the] general well-being of workers," 29 U.S.C. § 202(a) (emphasis added). More specifically, the Act "was designed to raise substandard wages and to give additional compensation for overtime work as to those employees within its ambit, thereby helping to protect this nation 'from the evils and dangers resulting from

[21] The substantive provisions of the FLSA reflect its limited purpose only to establish "rudimentary" wage and hour standards for employees. President Roosevelt's Message to Congress, reprinted, 81 Cong. Rec. 4960, 4961 (May 24, 1937). Section 6 of the Act fixed a floor for wages. In the first year, the minimum wage rate was 25 cents per hour; the next year the minimum increased to 30 cents per hour, and within seven years the minimum hourly wage rate for covered employees was to be 40 cents per hour. 52 Stat. 1062-1063. Similarly, Section 7 established a gradually declining regular workweek, and prescribed premium wage rates for hours worked in excess of the regular workweek. 52 Stat. 1063-1064.

wages too low to buy the bare necessities of life and from long hours of work injurious to health.' "[22]

President Roosevelt's May 24, 1937 Message to Congress urging adoption of wage and hour legislation identified both the problem and the basic solution (81 Cong. Rec. 4960):

> "Our nation so richly endowed with natural resources and with a capable and industrious population should be able to devise ways and means of insuring to all our able-bodied working men and women a fair day's pay for a fair day's work. A self-supporting and self-respecting democracy can plead no justification for the existence of child labor, no economic reason for chiseling workers' wages or stretching workers' hours."

"Chiselers," those employers who paid their workers starvation wages and demanded inhuman hours, were the problem. The solution was: "a fair day's pay for a fair day's work."

Congress found that millions of Americans were being paid less than 40 cents per hour, and being required to work far in excess of 40 hours per week.[23] The "limited" objective of the FLSA to address only the most extreme and oppressive labor conditions (*i.e.*, starvation wages

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[22] *United States* v. *Rosenwasser*, 323 U.S. 360, 361 (1945) (citation omitted); *see Rutherford Food Corp.* v. *McComb*, 331 U.S. 722, 727 (1947); *Donovan* v. *Agnew*, 712 F.2d 1509, 1517 (1st Cir. 1983).

[23] *See, e.g.*, S. Rep. No. 884, 75th Cong., 1st Sess. 4 (July 6, 1937); 81 Cong. Rec. 7648-7649 (July 27, 1937) (statement of Sen. Black); 82 Cong. Rec. 1390 (Dec. 13, 1937) (statement of Rep. Norton) (less than 19 cents per hour); 82 Cong. Rec. 1393 (Dec. 13, 1937) (statement of Rep. Welch) ($4-5 per week); 83 Cong. Rec. 9175 (June 14, 1938) (statement of Sen. Chavez) (12 cents per hour); 83 Cong. Rec. 9257 (June 14, 1938) (statement of Rep. Welch) ($3 per week, 60 hour weeks); 83 Cong. Rec. 9261-9262 (June 14, 1938) (statement of Rep. Schneider).

and sweatshops) was emphasized throughout the debate (82 Cong. Rec. 1395 (Dec. 13, 1937) (statement of Rep. Randolph) (emphasis added)):

> "Congress is . . . engaged in establishing for that class of workers who stand in need of them decent working conditions with respect to hours and wages. To this end the Black-Connery Fair Labor Standard Act is before us with *the sole purpose and aim of raising existing wages in the lower wage groups so as to attain as rapidly as possible and practicable a minimum wage of 40 cents an hour and a maximum workweek of not more than 40 hours.*"[24]

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[24] *See, e.g.*, S. Rep. No. 884, 75th Cong., 1st Sess. 4 (July 6, 1937) ("a start should be made . . . to protect this Nation from the evils and dangers resulting from wages too low to buy the bare necessities of life and from long hours of work injurious to health"); H.R. Rep. No. 1452, 75th Cong., 1st Sess. 9 (Aug. 6, 1937) ("only attempts in a modest way to raise the wages of the most poorly paid workers and to reduce the hours of the most overworked"); H.R. Rep. No. 2182, 75th Cong., 3d Sess. 6 (April 21, 1938) ("establishes a floor for wages, and a ceiling for hours, and abolishes child labor"); 81 Cong. Rec. 7648 (July 27, 1937) (statement of Sen. Black) ("provides a method of obtaining the objective of minimum wages and maximum working hours"); *id.* 7649 ("minimum wage sufficient to prevent [an employee] from dying from slow undernourishment and slow starvation); *id.* 7651 ("intended to prevent . . . the payment of wages which are below a necessary subsistence level"); *id.* 7658-7659 (Senate committee unanimously agreed to limit the bill strictly to minimum wages, maximum hours, and child labor"); Senator Black, "Wide Benefits Seen in Wage and Hour Legislation," *New York Times*, July 25, 1937, reprinted, 81 Cong. Rec. 774[illegible] (the bill "deals with labor conditions only"); President F.D. Roosevelt's Message to Congress, Nov. 15, 1937, reprinted, 82 Cong. Rec. 11 ("protect workers unable to protect themselves from excessively low wages and excessively long hours"); 82 Cong. Rec. 1390 (Dec. 13, 1937) (statement of Rep. Norton) ("aims to establish only the basic wage and hour levels"); *id.* 1392 ("a cautious step . . . toward the removal of oppressive wage and hour conditions"); 83 Cong. Rec. 9258 (June 14, 1938) (statement of Rep. Randolph) ("designed to bring up a little the wages at the bottom of the scale and regulate also the hours for

The problem Congress addressed in the FLSA was that employees were being paid "excessively low wages" and being required to work "excessively long hours" by their "chiseling" employers—not collection problems caused by insolvency.[25] The Fair Labor Standards Act was intended to address "labor conditions only," 81 Cong. Rec. (July 28, 1937); it was "strictly" limited to wage, hour, and child labor standards, 81 Cong. Rec. 7658-7659 (July 27, 1937) (statement of Sen. Black, sponsor and floor manager of the Senate bill and chairman of the Senate Committee on Education and Labor). An insolvent employer's inability to pay agreed wages in excess of the statutory minimum is irrelevant to the problem at which the FLSA was directed. The Act simply was not intended to address the consequences of an employer's insolvency and certainly was not intended to supersede other well-established creditors' rights statutes or the Bankruptcy Act.

Three undisputed facts make it inconceivable that Congress actually considered creating a "secret" trust or lien

the needy and underpaid workers of this country"); 83 Cong. Rec. 9260 (June 14, 1938) (statement of Rep. Schneider) (the bill "will go a long way to end the exploitation of the poorest paid, the hardest worked, and the most defenseless toilers"); 83 Cong. Rec. 9264 (June 14, 1938) (statement of Rep. Keller) ("purpose is to establish and maintain better national labor standards—not the standards which we hope labor may eventually and should attain and enjoy [through collective bargaining]—but minimum standards below which labor cannot be compelled to work and live"); *see generally Fair Labor Standards Act of 1937, Joint Hearings Before the Senate Committee on Education and Labor and the House Committee on Labor on S. 2475 and H.R. 7200*, 75th Cong., 1st Sess. (1937) (*"1937 Joint Hearings"*) 30, 33, 38, 39, 47, 55, 61, 74 (statement of Asst. Attorney General Robert H. Jackson); *id.* 173-174, 180-181 (statement of Secretary of Labor Frances T. Perkins).

[25] *See* H.R. Rep. 1452, 75th Cong., 1st Sess. 8 (Aug. 6, 1937); H.R. Rep. No. 2182, 75th Cong., 3d Sess. 6 (Apr. 21, 1938); 81 Cong. Rec. 7672 (July 27, 1937) (statement of Sen. Walsh).

for employee wage claims superior to a perfected security interest in inventory. First, as discussed (pages 19-22, *supra*), the sole limited purpose of the Act was to prevent chiselers from paying substandard wages.[26] Second, in 1938 there was little reason to consider potential conflicts between wage claims and the claims of creditors with interests in inventory collateral, because inventory and accounts receivable financing was in its infancy.[27] And third, Congress acted in 1938 against a substantial backdrop of state legislation and common law governing employee wage liens and the relative priority of all creditors, including unpaid wage earners. In the absence of solid evidence that Congress actually intended to preempt those laws, such an intent cannot be presumed. See pages 38-41, *infra*.[28]

[26] Three days before the FLSA became law, the same Congress amended the Bankruptcy Act of 1898. The Chandler Act of 1938, 52 Stat. 840 (1938). As amended, the Bankruptcy Act continued "the general purpose of Congress to . . . safeguard interests under liens perfected before bankruptcy," and continued to recognize the validity of prior perfected liens against unsecured claims entitled to priority under the Bankruptcy Act. *Goggin* v. *Division of Labor Law Enforcement of California*, 336 U.S. 118, 126-127 & n.8 (1949). Wage claims, entitled to second priority under the 1938 amendment to the Bankruptcy Act, remained junior to secured creditors. *See generally City of Richmond* v. *Bird*, 249 U.S. 174, 174-175 (1919); 3 *Collier on Bankruptcy* ¶ 507.[02] at 507-16 (15th ed. 1986) ("Only after the discharge of valid liens and encumbrances are assets available for distribution to priority claimants").

[27] *See generally* 1 G. Gilmore, *Security Interests in Personal Property* 128-145 (Factor's Lien Act); *see also id.* at 33-47 (chattel mortgages), 124-127 (Uniform Trust Receipts Act).

[28] Furthermore, if Congress had focused on these issues, the likelihood that it would have attempted to preempt state law is small. When Congress considered the FLSA, there was substantial uncertainty as to whether this Court would sustain Commerce Clause legislation prescribing minimum wage, overtime, and child labor standards. *Compare Carter* v. *Carter Coal Co.*, 298 U.S. 238 (1936); *Schechter Poultry Co.* v. *United States*, 295 U.S. 495 (1935); *Hammer* v. *Dagenhart*, 247 U.S. 251 (1918), *with NLRB*

Congress' concern about competition. The court of appeals' assertion that enforcing Section 15(a)(1) against a secured creditor serves any Congressional purpose to protect business against competition from goods produced under substandard conditions is wrong. Pet. App. 6a-7a, 10a. The basis for Congress' exercise of jurisdiction under the Commerce Clause was its finding that the existence of substandard "labor conditions" in industries "engaged in commerce or in the production of goods for commerce . . . . (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States; (2) burdens commerce and the free flow of goods in commerce; (3) constitutes an unfair method of competition in commerce; (4) leads to labor disputes burdening and obstructing commerce and the free flow of goods in commerce; and (5) interferes with the orderly and fair marketing of goods in commerce." 29 U.S.C. § 202(a).[29]

The court of appeals confused the mechanism for enforcement (and the jurisdictional basis) of the FLSA with its purpose. The sole purpose of the FLSA was to improve the conditions under which Americans worked by raising wages and reducing hours. Congress was concerned about competitors only to the extent that competition from "chiselers" had the effect of driving wages

v. *Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937); *see also Fair Labor Standards Act of 1937, Joint Hearings Before the Senate Committee on Education and Labor and the House Committee on Labor on S. 2475 and H.R. 7200*, 75th Cong., 1st Sess. (1937) ("*1937 Joint Hearings*") 1-89 (statement of Asst. Attorney General Robert H. Jackson). At that time, far more difficult constitutional issues would have been raised unnecessarily by an attempt to modify the priority of claims of creditors of insolvent debtors not in bankruptcy.

[29] *See, e.g., Maryland* v. *Wirtz*, 392 U.S. 183, 188-193 (1968); *United States* v. *Darby*, 312 U.S. 100, 109-110, 122 (1941).

down.[30] As Senator Black explained, "[l]ow wages control the wage scale, not high wages." 81 Cong. Rec. 7649 (July 27, 1937). The reference to "competition" in Congress' finding and declaration of policy reflects the attempt to bring the prescription of wages and hours within Congress' constitutional power to regulate interstate commerce, and to invoke every "hopeful approach to constitutionality" for prescription of wages, overtime, and child labor standards.[31]

[30] *See e.g.*, H.R. Rep. No. 1452, *supra*, at 9 (Labor Standards Board given power "to prevent competing, chiselling employers from undercutting decent, minimum wage standards or from stretching decent maximum-hour standards"); H.R. Rep. No. 2182, *supra*, at 6-7 ("No employer . . . need fear that he will be required by law to observe wage and hour standards higher than those applicable to his competitors. No employee . . . need fear that the fair labor standards maintained by his employer will be jeopardized by oppressive labor standards maintained by those with whom his employer competes"); 81 Cong. Rec. 7651 (July 27, 1937) (statement of Sen. Black) (the bill withdraws from "competitive conditions the wage level necessary for a person to live on"); *1937 Joint Hearings* 7, 60, 71 (statement of Asst. Attorney General Robert H. Jackson); *id.* 175, 178, 180, 183-184 (statement of Secretary of Labor Frances T. Perkins); *see generally Tony & Susan Alamo Foundation* v. *Secretary of Labor*, 471 U.S. 290, 302 (1985).

[31] As then Assistant Attorney General Robert H. Jackson explained, the draftsmen of the FLSA had attempted "to consolidate in a single bill all hopeful approaches to constitutionality, each complete in itself, so that if one or more falls at the hands of the Courts, we will not be left for an interval while a new bill is being adopted." *1937 Joint Hearings* 2; *see id.* 50-53, 85. Senate Bill 2475, Section 7(a), one of the predecessors to Section 15(a)(1) of the FLSA, was based on Justice Holmes' dissent in *Hammer* v. *Dagenhart*, 247 U.S. 251 (1918). *Id.* 58. If, as the administration hoped (*e.g.*, Roosevelt's May 24, 1937, Message to Congress), this Court accepted Justice Holmes' analysis and overruled or distinguished *Hammer* v. *Dagenhart*, the minimum wage and overtime provisions could be enforced through Section 15(a)(1) by prohibiting shipment or sale in interstate commerce of goods produced under substandard conditions, if all other "approaches to constitutionality" failed.

If Congress had sought to protect business against competition from goods produced under substandard conditions, enforcing Section 15(a)(1) against a secured creditor would not further that purpose. An employer-debtor's cost of production (including wages) is totally irrelevant to the foreclosing creditor, whose only interest is to sell the inventory at the best possible price to recover a loan, not to sell the goods cheaply to increase its share of the market. Compare Pet. App. 14a-15a.

2. Section 15(a)(1) was never intended to be invoked against innocent persons who acquire hot goods.

a. *Section 15(a)(1) as enacted in 1938.* The specific history of Section 15(a)(1) demonstrates that Congress broadly proscribed the sale of hot goods by "any person" to avoid circumvention of the substantive provisions of the Act by "chiselers" and those persons working in concert with them. Moreover, the history of the Act makes it plain that the "any person" language of Section 15(a)(1) was never intended to make secured creditors or other innocent, good faith purchasers of hot goods responsible for the wages of a seller's employees. The Secretary's position to the contrary is implausible, at best.

History of Section 15(a)(1). Consistent with the limits of the Commerce Clause, as understood in 1938, Section 15(a)(1) was intended to establish a mechanism for enforcing the minimum wage and overtime standards of the FLSA against *employers* throughout the chain of production and distribution of goods in interstate commerce. Limiting the reach of Section 15(a)(1) to offending "employers," however, would have provided an obvious and ready means of circumventing the substantive provisions of the Act. Accordingly, Congress proscribed the sale by "any person" of goods produced under substandard conditions, to reach the offending employer and any other culpable parties in possession of hot goods.

Assistant Attorney General Robert Jackson's explanation during the joint congressional hearings in 1937 of the intended operation of the legislation makes it clear that if Section 15(a)(1) had proscribed shipment or sale in interstate commerce only by employers who violated the wage and hour provisions, "the law would be a nullity, because they could farm out the parts of the work that they wanted to do under substandard conditions." *1937 Joint Hearings* 87.[32] The subcontractor would produce goods under substandard conditions and sell them within a state to its principal, who then would incorporate the goods into a finished product for shipment or sale in interstate commerce. See *1937 Joint Hearings* 85-87.[33] If Section 15(a)(1) had been limited to prohibiting shipment or sale only by the offending employer, it would not have prevented the shipment of the finished product by the principal. See id. Nor would a prohibition against interstate shipment and sales have been applicable to the subcontractor whose goods were intended for sale only within a state.[34] For that reason, Section 15(a)(1) prohibits "any person" from selling or shipping goods produced under substandard labor condi-

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[32] The "sweatshop" was one of the evils Congress hoped to eliminate by passage of the FLSA. "By the sweatshop is ordinarily meant a subcontractor; that is, a contractor who takes work from a principal and takes it out to do under contract in a shop which may be in his home or may be in hired premises." *1937 Joint Hearings* 196 (statement of Secretary of Labor Frances T. Perkins).

[33] *See also Rutherford Food Corp.* v. *McComb*, 331 U.S. 722 (1947) (rejecting contract labels in determining whether workers are "employees" or "independent contractors" for purposes of the FLSA).

[34] *See also* 83 Cong. Rec. 7399-7400 (May 24, 1938) (statement of Rep. Martin) (criticizing the child labor standards enforcement provisions, which authorized the Chief of the Children's Bureau of the Department of Labor to proceed against only producers, manufacturers, and dealers, Sections 12, 15(a)(4), 52 Stat. 1067, 1068, and therefore were subject to circumvention).

tions, "and the fact that you change the title by selling them from A to B before they go into interstate commerce does not affect it." *1937 Joint Hearing* 87.[35]

Thus, the hot goods provision was aimed at the chiseling employers who paid starvation wages and demanded inhuman hours of their employees. Congress had no desire to punish parties who acquired hot goods in good faith, without participation in any scheme to circumvent the substantive wage and hour provisions of the Act.[36] Section 15(a)(1) was not intended to nullify state lien statutes by establishing a federal wage lien.

Innocent purchasers.[37] Unlike the Secretary, Congress clearly recognized the distinction between "chiselers" and innocent purchasers when the FLSA was under consideration. The legislative history reflects the tension between drafting the Act broadly to avoid circumvention and avoiding the creation of a trap for innocent purchasers, but no one questioned the self-evident proposition that no innocent purchaser should be held responsible for the sins of his seller.[38]

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[35] *See, e.g., Hamlet Ice Co.* v. *Fleming*, 127 F.2d 165, 167 (4th Cir.), *cert. denied*, 317 U.S. 634 (1942) (rejecting intrastate seller's attempt to avoid FLSA).

[36] *See, e.g., 1937 Joint Hearings* 74-75 (statement of Asst. Attorney General Robert H. Jackson); *id.* 936-937, 941 (statement of George H. Davis, President, Chamber of Commerce of the United States).

[37] Under general commercial law principles, a secured creditor is a "purchaser." *See* Uniform Commercial Code §§ 1-201(32), (33).

[38] The Secretary cannot suggest that Section 15(a)(1) is a forfeiture provision, requiring relinquishment of the goods to the government. *See* note 11, page 9, *supra*; *see also* note 9, page 8, *supra*. During the hearings on the FLSA, Representative Thomas suggested that perhaps the proposed Labor Standards Board should be authorized to "go in and seize and forfeit [hot goods] wherever found, and by some proper provision, take care of the innocent purchaser or the innocent holder of the goods where he did not buy these goods that were produced under subnormal conditions knowingly." *1937 Joint Hearings* 70. Mr. Jackson acknowledged that forfeiture had proved effective in other contexts, but explained that such a provision in the FLSA might be problematic "from the point of view of constitutionality." *Id. See generally United States* v. *U.S. Coin & Currency*, 401 U.S. 715, 720-722 (1971); *United States* v. *One Ford Coach*, 307 U.S. 219, 236-237 (1939). Representative Thomas dropped the suggestion.

As introduced and reported out of committee in both Houses, the FLSA contained three provisions that clearly evidence Congress' concern that the breadth of Section 15(a)(1) should not be a trap for innocent parties. First, the term "goods" was defined to exclude "goods after their delivery into the actual physical possession of the ultimate consumer . . . other than a producer, manufacturer, or processor." 82 Cong. Rec. 1511-1512 (Dec. 14, 1937). Second, the proposed Labor Standards Board was authorized to issue "certificates of compliance" with the wage and hour standards of the Act: no innocent purchaser of goods from the holder of such a certificate would have been subject to prosecution by the Labor Standards Board under the Act.[39] On the floor of the Senate, the certificate of compliance provision was modified to permit a good faith purchaser to rely on a written representation of compliance from the seller. 81 Cong. Rec. 7891 (July 30, 1937) (statement of Sen. Murray).[40] Third, the Labor Standards Board was au-

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[39] 81 Cong. Rec. 7891 (July 30, 1937) (statement of Sen. Murray); S. Rep. No. 884, *supra*, 8; *see also* H.R. Rep. No. 1452, *supra*, at 18.

[40] Like the certificate of compliance provision, the amendment was phrased to protect an innocent purchaser from prosecution by the Labor Standards Board (81 Cong. Rec. 7891):

> "No person other than the producer shall be prosecuted for the transportation, shipment, delivery, or sale of unfair goods who has secured a representation in writing from the person by whom the goods transported, shipped, or delivered were

thorized to exempt goods from the prohibition of Section 15(a)(1), where "every person having a substantial proprietary interest in the goods had no reason to believe that any substandard condition existed in the production of the goods." [41]

In the House, the bill was resubmitted to committee for reasons unrelated to the protection afforded good faith purchasers.[42] On resubmission, the House committee eliminated the enforcement responsibilities of the proposed Labor Standards Board and, accordingly, omitted both the immunity from prosecution provision and the exemption authority.[43] Omission of these provisions in the House reflected the desire to simplify administra-

produced . . to the effect that such goods were not produced in violation of any provision of this act."

The reason for the modification was to reduce the burden of administering the Act. *Id.* There was no dispute as to whether an innocent purchaser should be subject to injunction under the predecessor of § 15(a)(1); that was self-evident. The bill initially reported by the House committee included the provision, as amended on the Senate floor. H.R. Rep. No. 1452, *supra*, at 18.

[41] S. Rep. No. 884, *supra*, 9; H.R. Rep. No. 1452, *supra*, 19. When an offending employer had a proprietary interest in the goods, the Labor Standards Board could exempt the goods only if the employer paid the wages due. S. Rep. No. 884, *supra*, at 9 ("in order to secure . . . exemption, provision must be made for *the payment of reparations by every employer* having a proprietary interest in the goods *who failed to maintain the required wage or hour standard*") (emphasis added); H.R. Rep. 1452, *supra*, at 19; *1937 Joint Hearings* 62. If the employer was financially unable to make the required wage payments, the provision would have been inapplicable. Thus, Congress clearly did not have in mind the situation of any insolvent employer.

[42] None of the provisions relating to good faith purchasers was criticized during the debate on the bill initially reported by the House committee.

[43] *See generally* H.R. Rep. No. 2182, 75th Cong., 3d Sess. 11, 12 (Apr. 21, 1938). The House committee also dropped the definition of the term "goods."

tion of the Act and avoid establishing yet another bureaucracy. The omissions are not mentioned in the House committee report, and there was no discussion concerning them on the floor.

The Conference Committee compromise established the Wage and Hour Division within the Department of Labor. Responsibility for enforcing the Act was vested in the Administrator of the division, thereby avoiding creation of a separate Labor Standards Board. Conference Report, reprinted, 83 Cong. Rec. 9246-9255 (June 14, 1938). The conference bill did not contain either the immunity from prosecution provision or the exemption authority provision, although the definition of "goods" in the Senate bill was retained. There is no evidence that the omission of these provisions reflected an intention to punish innocent purchasers of hot goods. Given the manifest concern (evident in the earlier versions of the bill) to avoid subjecting innocent purchasers to injunction under Section 15(a)(1), Congress' silence is deafening. "'We can be certain that there would have been . . . debate concerning consequences so wasteful, so inimical to purposes previously deemed important, and so likely to arouse public outrage.'" [44] Such a dramatic change of policy surely would have prompted at least one comment. There was none.

Incredibly, the Secretary has suggested in this Court that Congress' silent omission of the exemption authority provision reflected a "deliberate[]" decision to make secured creditors and other innocent parties responsible for the wrongs of others.[45] In light of the legislative

[44] *Kelly* v. *Robinson*, 107 S. Ct. 353, 362 (1986), quoting *TVA* v. *Hill*, 437 U.S. 153, 209 (1978) (Powell, J., dissenting).

[45] Resp. Br. in Opp. 10-11; *see also* Brief for the Secretary of Labor, Nos. 85-5249, 85-5252 (6th Cir.) 30-34. The Sixth Circuit correctly rejected the argument. Pet. App. 10a-11a n.10. The Secretary properly does not suggest that the omission of the immunity from prosecution provision implies any intention to punish innocent purchasers.

history of the Act, the only plausible inference that can be drawn from the omission of the exemption authority is that Congress reasonably concluded the provision was unnecessary. Only the Administrator of the Wage and Hour Division was authorized to enforce Section 15(a)(1). In any case where an exemption would have been appropriate, the agency could accomplish the same result by not seeking an injunction. If, contrary to common sense and Congress' manifest intention, the agency proceeded against an innocent purchaser under Section 15(a)(1), general principles of equity would permit a court to deny relief.[46]

b. *Section 15(a)(1) as amended in 1949.* The history of the only amendment to Section 15(a)(1) since 1938 reveals that Congress rejected the basic premise of the Secretary's argument.[47] In 1949 Congress amended the hot goods provision to correct a specific error in the Administrator's interpretation of the Act that fore-

[46] *See generally Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 313 (1982) ("The grant of jurisdiction to ensure compliance with a statute hardly suggests an absolute duty to do so under any and all circumstances, and a federal judge sitting as chancellor is not mechanically obligated to grant an injunction for every violation of law."); *Hecht Co.* v. *Bowles*, 321 U.S. 321 (1944); *cf. Shultz* v. *Factors, Inc., supra*; *Wirtz* v. *Powell Knitting, supra. See also Amendments to the Fair Labor Standards Act of 1938: Hearings Before the House Committee on Education and Labor* on H.R. 2033, 81st Cong., 1st Sess. (1949) (*"1949 House Hearings"*) 94-95 (statement of Harold C. Nystrom, Chief Interpretation Branch, Office of the Solicitor, Department of Labor) (discussing provisions of the Act governing child labor standards).

[47] Congress amended Section 15(a)(1) in 1949 by adding the following language (63 Stat. 919):

> "except that any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements [of the Act], and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful."

shadowed in some respects the Secretary's more extreme position in this case that Section 15(a)(1) was intended to require secured creditors to supervise the payroll practices of their debtors (see Resp. Br. in Opp. 14). The Administrator had asserted that certain ordinary commercial purchasers would be subject to injunction under Section 15(a)(1), if they failed to "police" their vendors' compliance with the wage and hour provisions of the FLSA.[48] The Administrator indicated that unless these purchasers included clauses in their contracts requiring their vendors to comply with the substantive provisions of the FLSA and "spot checked" their vendors' payroll practices "to detect any 'hot goods' in the making," they could not be considered innocent, good faith purchasers and, therefore, would be subject to prosecution under Section 15(a)(1).[49] According to the Administrator, "[t]his

[48] "Insurance Against 'Hot Goods'" reprinted, BNA, *Wage and Hour Manual* 937-939 (Cum. 1945). The Administrator noted that the problem had arisen most frequently "in connection with purchases of wood products by lumber concentration yards, chemical companies, pulpwood and paper companies, and other large users of timber products." *Id.* 937-938.

[49] *Id.* 938. Like the Secretary today, the Administrator attempted to justify his position by arguing that purchasers who monitored certain practices of their sellers should also check for compliance with the FLSA (*id.*):

> "Most chemical companies, lumber dealers, and pulpwood companies, which buy large quantities of wood, do not deal at arm's length with their suppliers. They employ woodsmen, buyers, foresters, and other representatives who are constantly in the field checking the operations of their contractors for various purposes—to see whether proper forestry practices are being observed; to see that the price paid for the wood is not too high; to see whether the contractor is desirable in other respects for future business dealings. There is no reason why these men should not at the same time 'spot check' the contractors' operations to see whether they are complying with the wage and hour provisions of the contract and to detect any 'hot goods' in the making."

Compare Resp. Br. in Opp. 14 ("lenders, including petitioner in this case, routinely monitor their borrowers' activities closely to

is the kind of 'policing' we have a right to expect . . ." in light of Section 15(a)(1). *Wage and Hour Manual* 938.

Unlike the Secretary in this case, however, the Administrator acknowledged the distinction between an innocent purchaser and the target of the FLSA, namely, the chiseler, "the man who has *failed to pay his employees* in accordance with the provisions of the Act *notwithstanding that he was financially able to do so." Wage and Hour Manual* 938 (emphasis added). Moreover, although mistaken as to what constituted an innocent, good faith purchase, the Administrator at least recognized that Congress never intended Section 15(a)(1) to be invoked against a person who acquired hot goods, innocently and in good faith. See id. 938-939.

Businessmen threatened with the prospect of enforcement action under the hot goods provision if they failed to "police" their vendors' compliance with the FLSA brought the Administrator's statement to the attention of Congress during the hearings preceding the adoption of the 1949 amendment to Section 15(a)(1).[50]

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ensure that the borrowers comply with both public law and their obligations to other creditors, lest a legal bar or a superior lien (for taxes, to a supplier, or to employees) bar the exercise of the lender's rights.").

[50] *See, e.g., Fair Labor Standards Act Amendments of 1949: Hearings Before a Subcomm. of the Senate Comm. on Labor and Public Welfare on S. 58, S. 67, S. 92, S. 105, S. 190, S. 248, S. 653*, 81st Cong., 1st Sess. (1949) ("*1949 Senate Hearings*") 882-883, 890, 898 (statement of John M. Higgins, Southern Pine Industry Committee); *Fair Labor Standards Act Amendments: Hearings Before a Subcomm. of the Senate Comm. on Labor and Public Welfare on S. 49 et al.*, 80th Cong., 2d Sess. (1948) ("*1948 Senate Hearings*) 580, 609 (statement of Joseph B. Fraser, Southern Pine Industry Committee); *see generally 1949 Senate Hearings* 943, 947 (statement of Thomas O. Moore, American Cotton Manufacturers Association); *id.* 1098 (statement of Chamber of Commerce, Philadelphia, Pennsylvania); *Amendments to the Fair Labor Standards Act of 1938: Hearings Before the House Comm. on Education and Labor on H.R. 2033*, 81st Cong., 1st Sess. (1949).

Industry representatives recognized that the Administrator's enforcement policy was inconsistent with the intended use of Section 15(a)(1).[51] Congressmen unequivocally confirmed that the Administrator's reading of Section 15(a)(1) swept far too broadly (*1949 House Hearings* 688, 690-691):

> "[Rep.] Barden: [W]e did not conceive of the Administrator using [Section 15(a)(1)] as he did.
>
> . . . . .
>
> "[Rep.] Jacobs: I do not personally think that a man who bought [the goods] innocently should be prosecuted.
>
> "[Rep.] Braden: We do not either . . .
>
> "[Rep.] Jacobs: The man who did wrong is the one they should get after.
>
> "[Rep.] Barden: That is right. That is what we intended. That is what we wanted to get.
>
> "[Rep.] Burke: In other words, you do not want to make the purchaser the policeman?
>
> "[Rep.] Barden: You do not want to punish innocent people." [52]

("1949 House Hearings") 660-661, 688-691 (statements of R.M. Eagle, John M. Higgins, Arthur Temple, Southern Pine Industry Committee).

[51] *1949 Senate Hearings* 898 (statement of John Higgins, Southern Pine Industry Committee) ("Congress probably did not intend that this should be the effect of [§ 15(a)(1)]."); *see 1949 House Hearings* 688 (statement of John Higgins, Southern Pine Industry Committee) ("No doubt that provision [§ 15(a)(1)] was put into the law to prevent your unscrupulous operator [*i.e.*, the chiseler] from just violating [the wage and hour requirements] wholesale."); *see also 1937 Joint Hearings* 936-937, 941 (statement of George H. Davis, President, Chamber of Commerce of the United States).

[52] For the convenience of the Court, relevant passages from the *1949 House Hearings* are reproduced in an appendix to this brief.

Thus, it was as clear in 1949 as it had been in 1938 that Section 15(a)(1) was not intended to be invoked against innocent purchasers. The Administrator's statement of enforcement policy revealed that he had misinterpreted the intended scope of Section 15(a)(1). Congress, therefore, made explicit what should have been obvious to all, and rejected the Administrator's stated enforcement policy.

The 1949 amendment permits a good faith purchaser in the ordinary course of business to avoid any potential application of Section 15(a)(1) by simply having the seller stamp or print on its invoice that its employees have been paid in accordance with the minimum wage and hour provisions. See 29 C.F.R. § 789.4 (1984).[53] The 1949 amendment protects a good faith purchaser, without imposing any extraordinary obligation to "police" the payroll practices of his seller or "to detect any 'hot goods' in the making." "The requirement that [the purchaser] must have made the purchase in good faith is comparable to similar requirements imposed on purchasers in other fields of law, and is to be subjected to the test of what a reasonable, prudent man, acting with due diligence, would have done in the circumstances." Conference Rep. No. 1453, reprinted in *1949 U.S. Code Cong. & Admin. News* 2251, 2271.[54]

Congress responded in 1949 to the specific problem raised by the Administrator's stated enforcement policy, and confirmed what was manifestly implicit in the Act, as adopted in 1938, namely, that Section 15(a)(1) was never intended to be invoked against innocent purchasers.[55] In correcting the Administrator's erroneous interpretation of Section 15(a)(1) as to one group of innocent purchasers, Congress did not thereby broaden its intended scope, or endorse the Secretary's expansive notion of the intended reach of the provision in this case as to secured creditors or other innocent parties.[56] The legislative history of the 1949 amendment makes very clear that Congress was not carving out a narrow exception to the intended reach of Section 15(a)(1). Rather, it was correcting a particular misinterpretation and misapplication of the provision by the Administrator. Representative Barden's criticism in 1949 of the Administrator's interpretation of what Congress intended is also true of the Secretary's position today: "You cannot conceive of 435 sensible men doing that . . . . But [Congress] did

[53] Some purchasers already had adopted comparable practices in 1949. *See 1949 House Hearings* 684 (statement of John Higgins, Southern Pine Industry Committee). App. 1a, *infra*.

[54] *See* H. Rep. No. 267, 81st Cong., 1st Sess. 39 (Mar. 16, 1949).

[55] As discussed, (pages 29-30, *supra*), the bill passed by the Senate and the bill initially reported by the House committee, included a provision comparable to the 1949 amendment, which would have protected a good faith purchaser who relied on its seller's written representation of compliance. 81 Cong. Rec. 7891 (July 30, 1937) (statement of Sen. Murray); *see* H.R. Rep. No. 1452, *supra*, at 19. Given the history of the 1938 legislation, the omission of the provision in conference almost certainly reflected the belief that the provision was unnecessary. In the unlikely event the Administrator proceeded against an innocent purchaser, the courts of equity would deny relief. *See* note 46, page 32, *supra*. The Administrator's statement of enforcement policy, however, made it appropriate to eliminate the threat, and Congress did so.

[56] Congress had no reason to address the application of Section 15(a)(1) to secured creditors in 1949, because from 1938 to 1966 neither the Administrator nor anyone else suggested that the provision should apply to secured creditors. *See Wirtz* v. *Powell Knitting*, *supra*, 360 F.2d 733. It is particularly unlikely that, if the issue had been raised, Congress would have approved the application of Section 15(a)(1) to secured creditors. If a seller refuses to provide the written assurance of compliance necessary to meet the standards of the 1949 amendment or if doubt exists as to the reliability of the assurance, a commercial purchaser in the ordinary course of business generally can turn to alternative suppliers. A secured creditor has no such option. It defies reason to suggest that in adopting the 1949 amendment, Congress intended that the only innocent purchasers who should be subject to Section 15(a)(1) are secured creditors, who are essentially involuntary purchasers.

not conceive of the Administrator [or the Secretary] using that [provision] as he did." *1949 House Hearings* 689 (statement of Rep. Barden), App. 1a, *infra.*

C. The General Language of a Federal Statute Should Not Be Construed to Preempt State Law *Sub Silentio*, Unless Essential to Accomplish the Purposes of the Statute.

State laws governing creditors' rights reflect the judgments of state legislatures as to the appropriate degree of protection to be afforded unpaid employees of financially distressed corporations. The holding of the Sixth Circuit, effectively establishing a secret federal lien or trust for wage claims with priority over earlier perfected security interests and, presumably, other consensual, statutory, or judicial liens, nullifies the contrary policy judgments of state legislatures throughout the country. Under the circumstances of this case, where there is no evidence of any legislative intent to address the relative priority of creditors' claims against insolvent debtors, this Court should not construe Section 15(a)(1) to preempt state law. "Our Federalism," *Younger* v. *Harris*, 401 U.S. 37, 44 (1971), requires rejection of a construction of a federal statute that preempts an area traditionally governed by state law, unless essential to accomplish the purposes of the statute or Congress' intent is otherwise clear.

Article 9 of the Uniform Commercial Code has been adopted by the legislature of every state in the country (except Louisiana), and by Congress for the District of Columbia.[57] Under Article 9 secured creditors generally are entitled to satisfaction of their claims out of property in which they have a perfected security interest before the property can be used to satisfy the claims of

[57] *See United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 732 n.28 (1979); *Slodov* v. *United States*, 436 U.S. 238, 257 n.22 (1978).

any unsecured creditors, including, for example, the claims of employees for unpaid wages.[58] Notoriety by notice filing is critical to the operation of Article 9, and to the underlying concept that a potential creditor should be able to determine the risks and the priorities of other creditors before extending credit. See, e.g., *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 739 n.42 (1979). With few exceptions, therefore, Article 9 avoids undisclosed and effectively undiscoverable secret liens or trusts that may defeat the claims of creditors with perfected security interests.[59]

In addition to Article 9 of the Uniform Commercial Code, there is a wide variety of state legislation specifically governing wage liens. See notes 60-62, *infra.* Much of this legislation antedates the Fair Labor Standards Act, and Congress doubtless was aware of it. The statutes reflect the many and varied policy judgments that state legislators have made in dealing with the difficult problems of who should be preferred to whom when there is not enough money to pay all the debts of an insolvent. For example, while some states extend protection to virtually all employees, others limit protection to employees in particular industries.[60] Other states limit the dollar

[58] *See* Uniform Commercial Code, §§ 9-201, 9-301(1), 9-312, 9-501 to 9-507; *see generally* White & Summers, *Handbook of the Law Under the Uniform Commercial Code*, 1030-1083 (2d ed. 1980).

[59] Mechanic's liens or repairmen's liens, which may take priority over a perfected security interest under Uniform Commercial Code § 9-310, are not "secret" in the sense in which the term is used here. Such liens are effective against a perfected security interest only if the goods are in the "possession" of the vendor. *E.g.*, *Forrest Cate Ford, Inc.* v. *Fryar*, 62 Tenn. App. 572, 577, 465 S.W.2d 882, 884 (1970); *see generally Note, The Priority Rules of Article Nine*, 62 Cornell L. Rev. 834, 907-918 (1977); Note, *Nonconsensual Liens Under Article 9*, 76 Yale L.J. 1649, 1656 & n.34 (1967).

[60] *Compare* Pa. Stat. Ann. tit. 43, § 221 (Purdon 1964) (virtually all employees) *with* Ala. Code § 35-11-90 (1977) (railroad em-

amount of the claims for which protection is provided; some impose no limitation.[61] Before Article 9 was adopted, some states arguably would have given priority to a wage lien over a previously perfected security interest; others clearly did not.[62]

Absent persuasive evidence that Congress intended to preempt these state laws governing the relative priority of creditors of insolvent corporations, the general language of a federal statute should not be construed to have such an effect.[63] "[T]he principal means chosen by the Framers to ensure the role of the States in the federal system lies in the structure of the Federal Government

ployees); Me. Rev. Stat. Ann. tit. 10, §§ 3201-4012 (1980 & 1985 Supp.) (miscellaneous specific categories); Miss. Code Ann. § 85-7-1 (1985 Supp.) (agricultural employees).

[61] *Compare* Cal. Civ. Code § 3061.5 (Deering 1985 Supp.) (agricultural laborers, two weeks earnings, 25% of value of severed crops, or 25% of sale proceeds, whichever is less); Del. Code Ann. tit. 10, § 4931 (1975) (New Castle County, $50 and one month); Minn. Stat. Ann. § 514.59 (West 1986 Supp.) ($1000 or 5 weeks net wages up to $3000, whichever is greater) *with* Alaska Stat. § 34.35.435 (1985) (clerk, accountant, bookkeeper, *et al.*); Ind. Code Section 32-8-24-1 (1986 Supp.)

[62] *Compare* Alaska Stat. § 34.35.435 (1985); Ark. Stat. Ann. Section 51-320 (1971); S.C. Code Ann. § 29-11-10 (1977); Tenn. Code Ann. § 66-13-101 (1982) *with* Del. Code Ann. tit. 8, § 300 (1975); Fla. Stat. Ann. § 713.58 (1986 Supp.); Ind. Code § 32-8-24-2 (1986 Supp.); Minn. Stat. Ann. § 514.59 (West 1986 Supp.); *see DiAngelo* v. *McCormick Bros., Inc.*, 168 A. 79 (Del. Ch. 1933); *Flynn-Harris-Bullard Co.* v. *Johnson*, 90 Fla. 654, 107 So. 358 (1925); *see also* Ga. Code Ann. § 44-14-380 (1982).

[63] *See, e.g., Louisiana Public Service Commission* v. *FCC, supra*, 106 S. Ct. 1899; *Philko Aviation, Inc.* v. *Shacket*, 462 U.S. 406, 409-411 & nn.2-4 (1983); *In the Matter of Gary Aircraft Corp.*, 681 F.2d 365, 368-372 (5th Cir. 1982) (Wisdom, J.), *cert. denied*, 462 U.S. 1131 (1983) (rejecting contention that Federal Aviation Act established federal priority scheme absent "strong reasons to believe that Congress intended to displace" state law in this area).

itself."[64] When generally-worded provisions of a federal statute are construed to supersede state policy judgments —without any evidence of consideration by Congress— the safeguards for federalism inherent in the structure of the national government cannot "perform[] as intended," *Garcia* v. *San Antonio, supra*, 469 U.S. 556.[65] "[T]he implications and limitations of our federal system constitute a major premise of all congressional legislation," and therefore Congress "will not be deemed to have significantly changed the federal-state balance . . . unless otherwise the purpose of the Act would be defeated."[66] The Secretary cannot satisfy the heavy burden of persuasion imposed by the "implications and limitations of our federal system" in this case.

The sole purpose of the FLSA to establish rudimentary wage and hour standards will not be impaired by rejecting the Secretary's position. The consequences of an employer's insolvency are far removed from the concerns that prompted enactment of the FLSA. The Act had nothing whatever to do with the priority of creditors'

[64] *Garcia* v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 550 (1985); *see generally* H. Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 Colum. L. Rev. 543 (1954).

[65] Whatever doubt there may be as to whether those "safeguards" are sufficient, *see Garcia* v. *San Antonio, supra*, 469 U.S. 565-566 & n.9 (Powell, J., dissenting); *id.*, 469 U.S. 584, 587 (O'Connor, J., dissenting), construing the general language of a federal statute to supersede state laws on matters of primarily local concern without evidence that Congress ever considered, much less intended such a result, renders those safeguards wholly ineffective.

[66] *Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2121 & nn.32-33 (1986) (plurality opinion) (citations omitted); *see Kelly* v. *Robinson*, 107 S. Ct. 353, 361 & n.11 (1986), quoting Frankfurter, Some Reflections on the Reading of Statutes, 47 Colum, L. Rev. 527, 539-540 (1947); *Kirschbaum Co.* v. *Walling*, 316 U.S. 517, 520-522 (1942).

claims against insolvent employers, and the *Powell Knitting* rule has governed for 20 years without any apparent ill effect on the Secretary's administration of the Act or the achievement of the Act's purpose. Reaffirming that rule in this case will have no greater impact.

D. The Construction of the FLSA Adopted by the Sixth Circuit Improperly Repeals by Implication Other Federal Statutes.

When Congress has intended to supersede state law governing the priority of creditors' claims or to create secret trusts or liens to assure payment of particular creditors, it has done so explicitly, with due regard to the interests of both secured creditors and otherwise controlling state law.[67] The court of appeals' construction of Section 15(a)(1) produces irreconcilable conflicts between the FLSA and other federal statutes that specifically address the priority of wage claims and inventory security interests as well as the interests of other creditors. "It is, of course, a cardinal principle of statutory construction that repeals by implication are not favored."[68] As this Court recently reiterated, "where . . .

[67] *See Mahon* v. *Stowers*, 416 U.S. 100 (1974) (holding that Congress did not intend to establish a secret trust or lien to assure payment of cattlemen in the Packers & Stockyards Act, 7 U.S.C. § 181). In 1976, Congress amended the Packers & Stockyards Act to create a statutory trust on the proceeds of sale for unpaid cattlemen. 7 U.S.C. § 196. Similarly, in 1984 Congress explicitly created a statutory trust for the protection of vendors of certain agricultural commodities. Perishable Agricultural Commodities Act, 7 U.S.C. § 499e(c). *See also* Section 3466 Rev. Stat., 31 U.S.C. § 3713; Federal Tax Lien Act of 1966, 26 U.S.C. Sections 6321-6323 (priority dates from the filing of notice and is junior to prior perfected security interests).

[68] *Radzanower* v. *Touche Ross & Co.*, 426 U.S. 148, 154 (1976), quoting *United States* v. *United Continental Tuna Corp.*, 425 U.S. 164, 168 (1976); *see generally* 1A *Sutherland Statutory Construction* ¶ 23.10 at 346-354 (4th ed. 1985).

statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective."[69] Accordingly, the language and structure of the FLSA and the legislative history described above (pages 14-38, *supra*) are equally relevant here, because they demonstrate that Congress simply did not intend to address creditors' rights in enacting the FLSA.

Under the Bankruptcy Code, a trustee is obligated to liquidate the bankrupt's estate including inventory. The order of distribution of the proceeds is precisely described in the Bankruptcy Code. 11 U.S.C. § 507. Wage claims cannot lawfully be paid ahead of liens and costs of administration. "Only after the discharge of valid liens and encumbrances are assets available for distribution to priority claimants." 3 *Collier on Bankruptcy* ¶ 507.02 [2] at 507-16 (15th ed. 1986).[70] Under the Bankruptcy Code, wage claimants have third priority, but all "[a]ssets of a debtor in the trustee's hands are subject to all of the equities, liens, and encumbrances . . . that exist at the date of bankruptcy . . . ." Id. If a trustee in bankruptcy is a "person" within the meaning of the FLSA, however, he could be enjoined from selling inventory or from distributing proceeds as required by the Bankruptcy Code.

The same conflict existed under the Bankruptcy Act, as it existed in 1938. As explained (note 26, page 23, *supra*), the same Congress that adopted the FLSA also adopted the Chandler Act, which continued the protection afforded secured creditors under the bankruptcy laws. *Goggin* v.

[69] *Ruckelshaus* v. *Monsanto Co.*, 467 U.S. 986, 1018 (1984) (internal quotation marks omitted); *see Morton* v. *Mancari*, 417 U.S. 535, 551 (1974); *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 357 (1963).

[70] *See generally* 3 *Collier on Bankruptcy* ¶¶ 506.02, 507.02, 507.03 (15th ed. 1986); 2 G. Gilmore, *Security Interests in Personal Property* 1051 (1965); *see also Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730, 733 (2d Cir. 1966).

Division of Labor, supra, 336 U.S. 126-127 & n.8. A prior perfected secured creditor was entitled to be paid in full, before any payment of employee wage claims entitled to second priority under the bankruptcy law, as it existed in 1938.

The Federal Tax Lien Act of 1966, 26 U.S.C. §§ 6321, *et seq.*, establishes a lien on all the property of a delinquent taxpayer, and prescribes the relative priority between the tax lien and private creditors. The tax lien is enforceable by sale, subject to prior perfected security interests. Under the Secretary's theory, agents of the Internal Revenue Service would be unable to sell inventory or take the proceeds of the sale of inventory ahead of Ely employees' wage claims. Agents of the IRS are clearly within the phrase "any person" in the literal sense, but just as clearly were not intended to come within the scope of Section 15(a)(1). To the extent a taxpayer's property is insufficient to satisfy both employee wage claims and the tax claim, the federal tax lien is impaired. Congress' specific intention in creating the lien to assure collection of tax revenues would be thwarted.[71]

In the Packers and Stockyards Act, Congress provided that "livestock purchased by a packer in cash sales, and

[71] Further, because a federal tax lien is subordinate to the prior perfected security interest of a commercial lender, 26 U.S.C. § 6323 (a), (c), the Secretary's construction of the FLSA may produce unintended and highly undesirable "circular priority" problems. *See generally* 2 G. Gilmore, *Security Interests in Personal Property* 1020-1046 (1965). A federal tax lien is subordinate to the prior perfected security interest of a commercial lender, but the tax lien is superior to later unsecured wage claims. The employee wage claims (according to the Secretary) would be superior to the senior security interest. If this circularity of liens and claims existed when bankruptcy proceedings were initiated, the Secretary's interpretation of Section 15(a)(1) would also disrupt the Bankruptcy Code priority system, again contrary to Congress' clearly expressed intentions. *See generally* 3 *Collier on Bankruptcy* ¶ 507.03 (15th ed. 1986).

all inventories of, or receivables or proceeds from meat shall be held by such packer in trust for the benefit of all unpaid cash sellers of such livestock until full payment has been received by such unpaid sellers" (7 U.S.C. § 196(b)). Congress' specific intention under the Packers and Stockyards Act was to protect a seller of cattle at least in part from the consequences of a packer's insolvency. Under the Secretary's interpretation of the FLSA, however, an unpaid livestock vendor could be enjoined from recovering and selling his cattle or the products thereof whenever the defaulting packer had failed to pay his employees. In any case in which both the FLSA and the Packers and Stockyard Act apply, one or the other must give way. Congress' purpose in enacting the Packers and Stockyards Act cannot be accomplished, if, as the Secretary maintains, "employees have priority" under the FLSA (page 7, *supra*).

Similarly, in the Perishable Agricultural Commodities Act ("PACA"), 7 U.S.C. § 499e(c), Congress attempted to protect the sellers of certain agricultural commodities by establishing a "trust" on the "inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products." Under the Secretary's interpretation of Section 15(a)(1), however, employee wages must be paid first, and the specific purpose of the PACA provision would be frustrated.

The inevitable conflict with Congress' explicit intention in other statutes to establish federal priority rules to assure payment of particular creditors and collection of tax revenues is one more reason for rejecting the Secretary's interpretation of the FLSA. The conflict is completely avoided by refusing to extend the FLSA beyond the area in which Congress intended it to govern: wage and hour standards.

E. The Well-Settled Construction of the FLSA Adopted in *Powell Knitting* Should Not Be Abandoned.

The Second Circuit rejected the Secretary's first attempt to extend the reach of the Fair Labor Standards Act to secured creditors. *Wirtz* v. *Powell Knitting Mills Co.*, 360 F.2d 730 (2d Cir. 1966). In 1971, the Fourth Circuit rejected another effort by the Secretary to extend the reach of the Fair Labor Standards Act. *Shultz* v. *Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971). The holding of the court of appeals in *Powell Knitting* remained settled law until this litigation.

Congress is presumed to have been aware of the Second Circuit's holding in *Powell Knitting.*[72] Congress has not modified Section 15(a)(1) to overrule *Powell Knitting*, although the Fair Labor Standards Act has been amended on at least four occasions since *Powell Knitting* was decided 20 years ago.[73] Congress' failure to amend Section 15(a)(1) is evidence that the provision was never intended to establish a secret lien or trust for wage claims, or to be used as a club for "judicial extortion" (C.A. App. 66-67) to force a secured creditor to pay its debtor's employees.

Notwithstanding the Secretary's apparent continuing misuse of Section 15(a)(1) to coerce secured creditors to pay the wages of the employees of insolvent debtors, since 1966 governing judicial authority has held that Section 15(a)(1) is not applicable to secured creditors. Before 1966 no one suggested the contrary. There is no evidence that the Secretary's administration of the FLSA has been affected in the slightest, or that the absence of

[72] *See Bowen* v. *American Hospital Association*, 106 S. Ct. 2101, 2113 (1986) (plurality opinion); *Cannon* v. *University of Chicago*, 441 U.S. 677, 696-697 (1979).

[73] *See, e.g.*, Pub. L. 99-150, 99 Stat. 787 (Nov. 13, 1985); Pub. L. 95-151, 91 Stat. 1245 (Nov. 1, 1977); Pub. L. 93-259, 88 Stat. 55 (Apr. 8, 1974); Pub. L. 89-601, 80 Stat. 830 (Sept. 23, 1966).

authority to pursue secured creditors has in any way impeded accomplishment of Congress' objective. Nor does it appear that the Secretary ever sought legislation to overrule *Powell Knitting*. Instead, the Secretary filed these cases, because *Powell Knitting* "was a 1966 decision, [and] we needed to make some new law." C.A. App. 263 (testimony of Mr. J. Dean Speer, Department of Labor, Area Director).

After nearly 50 years, a settled construction of a national statute should be changed, if at all, only by Congress.[74] *Powell Knitting* was correctly decided in 1966. Even if there were some basis for concluding that the Second Circuit was wrong in *Powell Knitting*, however, judicial re-examination of the rule would be inappropriate at this late date. Whether the product of a decision of this Court or a well-reasoned decision of a lower federal court, a settled rule of law should not be reconsidered, unless it has been the source of some substantial practical difficulties.[75] Rejection of causal invitations "to make new law" is simply sound judicial administration. "[I]mitation of the past, until we have a clear reason for a change, no more needs justification than appetite. It is a form of the inevitable to be accepted until we have a clear vision of what different things we want." [76]

State law governing the priority of creditors' claims against insolvents on the one hand, and the FLSA gov-

[74] *E.g.*, *Square D Co.* v. *Niagara Frontier Tariff Bureau Inc.*, 106 S. Ct. 1922, 1930-1931 (1986); *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1983); *see Donovan* v. *Agnew*, 712 F.2d 1509, 1514 (1st Cir. 1983).

[75] *Cf. International Union, United Automobile, Aerospace and Agricultural Implement Workers of America* v. *Brock*, 106 S. Ct. 2523, 2533 (1986); *see also United States* v. *Maine*, 420 U.S. 515, 528 n.9 (1975) ("the doctrine of *stare decisis* carries particular force where the effect of re-examination of a prior rule would be to overturn long-accepted commercial practice").

[76] *Thomas* v. *Washington Gas Light Co.*, 448 U.S. 261, 272 n.17 (1980), quoting O. Holmes, *Collected Legal Papers* 290 (1920).

erning minimum wage and hour standards on the other have existed side-by-side for nearly 50 years. Until the Sixth Circuit's decision in this case, creditors' rights and labor standards were governed by entirely distinct bodies of law, without apparent difficulty. Neither the Secretary nor the court of appeals has offered any persuasive basis for eliminating the common sense, workable, bright line between creditors' rights and wage and hour standards that has prevailed since the FLSA was enacted in 1938.

Re-examination of the *Powell Knitting* rule would disrupt the complex scheme of interrelated state laws governing the priority of creditors' claims. As this Court correctly observed: "In structuring financial transactions, businessmen depend on state commercial law to provide the stability essential for reliable evaluation of the risks involved." *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 739 (1979). The most obvious consequences of discarding the longstanding *Powell Knitting* rule are fairly predictable. Particularly in labor-intensive industries, in which the normal outstanding payroll is a relatively larger percentage of unsecured debt, adopting the Secretary's interpretation of Section 15(a)(1) would tend to discourage secured lending and increase the costs to borrowers.[77] In addition, commercial lenders would be forced to reevaluate the adequacy of their collateral and the availability of additional funding under existing agreements, which were negotiated in reliance on the authority of *Powell Knitting*. Nonetheless, it is impossible to foresee all the ultimate consequences of interposing Section 15(a)(1) as a device for modifying the priority of creditors' claims to inventory collateral established under state law. Determination and evaluation of the

[77] *See generally* T. Jackson & A. Kronman, *Secured Financing and Priorities Among Creditors*, 88 Yale L.J. 1143, 1147-1149, 1163 (1979).

consequences of modifying established commercial practices should be left to Congress.[78]

Thus, the Sixth Circuit's re-examination of the rule firmly established in *Powell Knitting* needlessly raises issues that are best left to Congress. The competing interests of commercial lenders and employees of insolvent employers, the consequences to the commercial financing industry of changing the rule, and the extent to which (if at all) *Powell Knitting* has impeded the purpose of the FLSA, are all matters that should be determined only after "careful legislative deliberation." In short, this is a case in which it is demonstrably true that "it is more important that the applicable rule of law be settled than that it be settled right." [79]

[78] *Cf. United States* v. *Kimbell Foods, supra,* 440 U.S. 739-740 ("Because the ultimate consequences of altering settled commercial practices are so difficult to foresee, we hesitate to create new uncertainties, in the absence of careful legislative deliberation") (footnote omitted).

[79] *Square D Co.* v. *Niagara Frontier Tariff Bureau, Inc.*, 106 S. Ct. 1922, 1931 (1986), quoting *Burnet* v. *Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting); *United States* v. *Kimbell Foods, Inc., supra,* 440 U.S. 739-740.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted,

REX E. LEE *
GEORGE W. JONES, JR.
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000

A. BRUCE SCHIMBERG
SIDLEY & AUSTIN
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

Counsel for the Petitioner

* Counsel of Record

APPENDIX

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Excerpts from Hearings Before the House Committee on Education and Labor on H.R. 2033, 81st Cong., 1st Sess. 684, 688-689, 690-691 (1949):

"Mr. Higgins. Of course, the position I am in in buying from those mills is that if I buy from them, they come in and represent to me that they have complied with the wage-and-hour law. In fact, when we give them a check, we have stamped on the back that they have certified in signing the check and in endorsing that check that they have complied with the Fair Labor Standards Act of 1938. Beyond that, we cannot make a detailed investigation to tell whether or not they are actually complying.

"As I understand the present law, if we do make a mistake of buying from a mill that is actually not complying with the law, our entire inventory is subject to being frozen. We would be enjoined from shipping in interstate commerce. And, of course, in my business that would cripple me, because 90 percent of my production goes into carload shipments in interstate commerce.

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"[Rep.] Barden. [I]f he signed that check, just as you say he signed it, certifying that those logs were produced under the Wages and Hours Act, and the logs are sawed and the lumber goes into your yard, with your 1,000,000 feet of lumber on there, and it is caught and they go to the man and trace it and find him way back in the woods, and they ask, "Where did those logs go?" and he says they went to your mill, they come to you and ask, "Did you saw those logs?" You answer, "Yes, sir." They reply "O.K. Your 1,000,000 feet of lumber is hot goods." The whole 1,000,000 feet is hot goods and remains hot goods—to show you how big a mistake we can make, it remains hot goods—and there is no legal

way to extricate it from that contraband status, and you are prohibited from shipping it, selling it, or doing anything; not until the ban is lifted, but for all time.

"You cannot conceive of 435 sensible men doing that, can you? But we did not conceive of the Administrator's using that as he did. Here is how he used it: He took that clause; he would go to your man. It did not make any difference what those investigators found right, wrong, or otherwise, but assuming that they estimated—and they have a way of estimating; they do not go by the clear-cut figures. They have the authority to estimate, and we gave it to them. They go to you and say, "Listen, you either pay what we say you pay or 'bingo!' you are out of commission."

I happen to know where there was not any way for one man to appeal; there was not any way for him to argue. He got hit for approximately $20,000, and he came to my home, and he begged and begged and begged and begged. He said, "Can't I appeal? Can't I do this?"

"I said, "No: There it is."

"And three days later, he was a dead man.

"There was nothing I could do, but the Administrator says, "If you pay this we will just shut our eyes and let you go ahead and ship your lumber."

"That is not right, and that has been the practice. He exercises the right to lift the ban on the hot goods, and he has no more right to do it than you or I under this law.

"Here is the attorney [for the House Committee] sitting right here, and he is supposed to know whether I am right or wrong. If I am wrong, you are supposed to set me right.

"[The Administrator] has been exercising the privilege of using that as a club, and then saying to you, "Now, if you will go ahead and behave yourself, we will let you ship it and say nothing about it."

"Isn't that correct?

"Mr. Higgins. That is my understanding; yes, sir.

"[Rep.] Barden. And that is still written into the lawbooks right now.

"Mr. Higgins. No doubt that provision was put into the law to prevent your unscrupulous operator from just violating it wholesale.

"[Rep.] Barden. That is what we had in mind.

"Mr. Higgins. Yet, on the other hand, if I buy from 10 mills and only one of them ships a little in there and I do not know about it, then if that is uncovered later, the entire production of the 10 mills is stopped.

"[Rep.] Barden. As hot goods?

"Mr. Higgins. It is stopped at our concentration yard.

"[Rep.] Barden. And the thing that astounds me is the fact that we woke up and found that we had provided no method whatsoever for cooling off those goods. We got them hot, but we provided no cooling system for them, to where you could ever ship them again, except that the Administrator would tell you, "Well, you be a good boy and I will just wink at you. Go ahead and ship them."

* * * *

"[Rep.] Jacobs. I just want to know from the attorney; Is it the correct application of the law in the past that, if this operator purchases lumber or logs that were not produced under the standards described by the law and does so innocently, his lumber is then condemned?

"Mr. Forsythe [counsel to the House Committee]. That is right. As a general proposition, the intent and knowledge of the man who bought it does not

matter, as long as it is a violation to continue selling, once you know or it is brought to your attention that it is "hot."

"[Rep.] Barden. May I follow that with one question? There is no cooling system provided for it; is there?

"Mr. Forsythe. Not that I know of.

"[Rep.] Jacobs. I do not personally think that a man who bought it innocently should be prosecuted.

"[Rep.] Barden. We do not, either; but that is how big a mistake we can make.

"[Rep.] Jacobs. I suppose the price he paid would go to the question of intent.

"[Rep.] Barden. No; that would not have any thing to do with it, Mr. Jacobs. It would in a legal proceeding, in determining whether he was buying it in good faith. If he bought it way low, that would be strong evidence that he knew it was being produced in violation of the law.

"Mr. Higgins. That may be right, sir.

"[Rep.] Barden. And if he was to pay John Doe out here, who was running a little mill, $51, and then pay Bill Smith, who runs one over there, $50. Mr. Higgins would not get any more lumber. He might get a 2 by 4 wrapped around his neck.

"[Rep.] Jacobs. The investigator should go to the mill back in the woods and get after that fellow and make him pay up.

"[Rep.] Barden. The investigator was sent down there to get somebody. That was the philosophy of it.

"[Rep.] Jacobs. I do not say that. I am not dealing with any personalities. I am talking about the principle of the thing. The man who did wrong is the one they should get after.

"[Rep.] Barden. That is right. That is what we intended. That is what we wanted to get. But we

just made—well, a mistake; did we not, Mr. Chairman?

"[Rep.] Burke. In other words, you do not want to make the purchaser the policeman?

"[Rep.] Barden. You do not want to punish innocent people. You do not, and I do not.

"[Rep.] Jacobs. [*sic*] I think this, sir: If an investigator came to a mill or a concentration yard, such as mine, and found that that operator was buying from, say, 10 of these peckerwood mills, and he found 9 of those mills in complete accord with the act, and he found 1 fellow way off out around the Coosa River violating the law, then he should know that the concentrator is not intentionally in violation of the law. It just does not make any sense that he would have one mill set up out here which owned the small quantity that he produced and have him bringing in something that would give him the risk of having "hot goods."

"[Rep.] Barden. Your common sense would direct you. You have too much at stake. If he had the intelligence of a moron, he would not take that chance.

"Mr. Higgins. But, on the other hand, if he had an operation such as mine and found one or two mills that were more accessible which were adhering to all the provisions of the Fair Labor Standards Act, and found eight stuck out in the woods and working like the devil to violate the law, then he should have his stuff tied up.

"[Rep.] Barden. That is right. We would have reasonable grounds to assume that he was no longer an innocent man.

"Mr. Higgins. That is right. The frequency of the violation should enter into it."